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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Treatment of Operator Services Under Price Cap Rules for AT&T	)	CC Docket No. 93-124
	)	
Revisions to Price Cap Rules for AT&T	)	CC Docket No. 93-197

COMMENTS OF TIME WARNER COMMUNICATIONS HOLDINGS, INC.

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COMMENTS OF TIME WARNER COMMUNICATIONS HOLDING, INC.

INTRODUCTION

As contemplated by the Federal Communications Commission's ("Commission") November 13, 1995 Order on Motion for Extension of Time in the referenced docket,[1] Time Warner Communications Holdings, Inc. ("TW Comm") responds herein to Issues 19 and 20 and paragraph numbers 159 through 172 of the Local Exchange Carrier ("LEC") Pricing Flexibility Notice of Proposed Rulemaking ("NPRM").[2]

TW Comm opposes changing the LEC Price Cap Plan to link the X-Factor with the state of competition. Any linkage

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[1] The Order indicated that parties could either submit their comments on these issues together with their comments responsive to the X-Factor NPRM, or, as TW Comm has elected to do, submit them separately.

[2] In re Price Cap Performance Review for Local Exchange Carriers, Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, Further Notice of Proposed Rulemaking in CC Docket No. 93-124, and Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197, FCC 95-393 (September 20, 1995).

necessarily presupposes a causal relationship between the X-Factor and the competitiveness of the local services market. At best, such an underlying assumption should be regarded with extreme skepticism. The price cap mechanism for LECs, of which the X-Factor is an integral part, was designed to provide LECs with incentives to be more efficient, despite their virtual monopoly status. Except in the broadest sense of exerting downward pressure on prices, price caps were not designed to provide LECs with incentives to become competitors; rather, they were designed to constrain LEC market power for the benefit of consumers.

Price caps would be unnecessary if true competition existed to provide LECs with real market economic incentives to maintain competitive prices and to operate efficiently. In reality LECs today have virtual immunity from competitive forces in many geographic areas, across a range of services. That being the case, the need for Commission intervention in the market in the form of the Price Cap Plan and its incumbent X-Factor continues to exist.

Under these circumstances, attempting to adjust the X-Factor in a way that accurately responds to changing market conditions is an undertaking that is doomed to fail. Because it is based on a false premise - that a causal relationship between the X-Factor and competitiveness exists - decreasing the X-Factor as a response to the growth of competition could result in excessive earnings by the LECs that would enhance their ability to engage in predatory pricing where competition is just beginning to develop.[3] Such a result could cause significant harm to the fledgling competitive marketplace.

A. Changes to the LEC Price Cap Plan

1. X-Factor Flexibility - Issues 19a, 19b, and 19c

If the Commission adopts optional rather than mandatory X-Factors, the use of relaxed regulatory relief is unlikely to significantly encourage or influence a Price Cap LEC's decision to elect a higher or lower X-Factor. Minor regulatory relief probably would not provide sufficient economic incentives for a LEC to agree to attempt to achieve the more difficult target established via utilization of a higher X-Factor. If the regulatory flexibility granted is so significant that it would affect a company's choice of an X-Factor, it runs the risk of being the cause of distortions in the market because of unchecked LEC market power. Market prices should decrease in response to a reduction in actual costs, not merely a perception of an opportunity for the LECs to "game" their Price Cap Plans.

2. Relaxation of Sharing Requirements - Issues 20a, 20b

Growth in true facilities-based competition theoretically could replace the "flow-through" function of the current sharing requirements if, in fact, competition was sufficient to constrain

[3] In fact, a firm moving from a monopoly to a competitive market can be expected to increase efficiency in order to meet competition. Thus, a case could be made that the productivity factor should be increased to recognize the improved efficiency resulting from the introduction of competition.

LEC earnings. However, the existing state of competition does not warrant the removal of earnings sharing, nor is it likely to do so in the immediate future.

NYNEX's proposal to eliminate sharing based on the percentage of lines in a study area that meets its list of competitive criteria is critically flawed because it is based on far too gross a measurement. NYNEX is essentially arguing that the potential for competition, i.e., LEC implementation of measures to allow local competition, is equivalent to actual competition. The possibility of an error in judgment in measuring the extent of potential competition cannot be discounted. Furthermore, NYNEX's proposal to eliminate earnings sharing is unnecessary. If true effective competition existed, LECS would not be able to accumulate excess earnings and the sharing mechanism would not be triggered.

Earning sharing's twin goals, correcting for X-Factor inaccuracy and ensuring that consumers receive some of the benefits of the Price Cap Plan, do not disappear with the advent of potential competition. The fact that a LEC has taken certain steps to allow competition is not enough to justify the removal of earnings sharing. Significant fundamental and underlying barriers to entry continue to exist in many areas, including operations, that effectively preclude competitors from entering the market. Before earnings sharing should be displaced by reliance on competition, the LECs must be required to conclusively demonstrate that they _in fact_ face real facilities-based competition.[4]

Accordingly, the Commission must continue to constrain LEC prices and earnings until competition is sufficiently developed to act as a meaningful constraint on LEC market power and earnings. The fact that a small portion of the LEC serving area may become competitive does not justify decreased price and earnings constraints in those areas where the LEC continues to exercise considerable market power. Moreover, LECs do not need price cap incentives to improve efficiency in a truly competitive market, as competition itself provides the best economic incentive. Indeed, the Commission must seriously question the LECs' anxiousness to reduce price and earnings constraints. If competition develops to a level that justifies such flexibility, the existence of price and earnings caps would be moot since competition would act similarly and the LEC would in no way be disadvantaged by the existence of such caps.

The fact is, however, that LEC earnings have increased dramatically under price cap regulation.[5] With no meaningful competition in sight for the foreseeable future, further relaxation of regulatory controls under the misguided mantra of

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4 The Commission's consideration of these issues should be undertaken in isolation but should be reviewed in context with the Commission's consideration of the pricing flexibility NPRM issues.

5 According to _Telecommunications Reports_, Volume sixty-one, No. 42, October 23, 1995, for example, BellSouth and Cincinnati Bell experienced record earnings growth for the third quarter of 1995. Excluding one-time items, Ameritech's earnings per share increased 10.5 percent, and Bell Atlantic's net income rose 11.2 percent. GTE's earnings per share also increased by 100 percent.

potential competition could be expected only to lead to additional increases in LEC earnings without meaningful progress towards competitive goals.

CONCLUSION

TW Comm is opposed to any proposal that attempts to link competition with the X-Factor or earnings constraints in price caps. The conceptual underpinnings of the X-Factor and price caps are antithetical to competitive markets. The Commission should not expect X-Factor modifications to positively influence market competitiveness.

Respectfully submitted,

TIME WARNER COMMUNICATIONS HOLDINGS, INC.

Its Attorneys

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January 11, 1996

CERTIFICATE OF SERVICE

I, Yvonne M. Coviello, hereby certify that on this 11th day of January, 1996, a true copy of the foregoing Comments filed by Time Warner Communications Holdings, Inc., were Hand Delivered, upon each of the parties listed.

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